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SUBJECT: SRI LANKA: COMMERCE A/S LASH PUSHES INVESTMENT
CLIMATE ISSUES

1. Summary: Following up on President Bush's July commitment to Prime Minister Wickremesinghe to examine areas for greater economic engagement with Sri Lanka, William H. Lash III, Assistant Secretary of Commerce for Market Access and Compliance, brought a Commerce Department delegation to Sri Lanka December 19-20 to assess areas for economic and commercial engagement with the Government of Sri Lanka (GSL). A/S Lash used his visit to press GSL to improve the investment climate and to approve several pending proposals by U.S. companies. He delivered these messages during separate meetings with Minister of Commerce and Consumer Affairs Ravi Karunanayake, Minister of Finance K.N. Choksy and Board of Investment Chairman Arjunna Mahendran. A/S Lash also engaged leading business representatives to hear their concerns on Sri Lanka's investment climate. A press conference by A/S Lash led to widespread coverage of the visit. The visit succeeded in focusing the GSL on steps it needs to take to strengthen its trade and commercial ties with the U.S. End Summary.

2. William H. Lash III, Assistant Secretary of Commerce for Market Access and Compliance, brought a Commerce Department delegation to Sri Lanka December 19-20 to assess areas for economic and commercial engagement with the Government of Sri Lanka. The Commerce Department delegation consisted of A/S Lash; J.V. Schwan, Counselor to A/S Lash; Linda Droker, Director for South Asia and Oceania; and Art Stern, India/Sri Lanka Desk Officer.

Meeting with Minister of Commerce

3. A/S Lash met on December 20 with Minister of Commerce and Consumer Affairs Ravi Karunanayake. A/S Lash began by explaining that his visit was a direct outcome of the President's commitment to Prime Minister Wickremesinghe, made during their July meeting at the White House, to examine areas for greater economic engagement with Sri Lanka. The U.S. is following closely Sri Lanka's economic reforms, he said. Sri Lanka had already pulled ahead of the rest of South Asia in terms of openness and average standard of living, in spite of years of conflict. Now, with the prospects for peace stronger than ever, the best way for Sri Lanka to attract foreign investment, and thereby raise average income levels, is to improve further its investment climate.

4. A/S Lash went on to exhort Sri Lanka to become an example within South Asia of sound IPR protection. Effective IPR protection, he said, was a key factor for U.S. companies when evaluating countries for potential investment. With many U.S. firms considering technology and patents their greatest assets, domestic protection of this property will be critical to Sri Lanka attracting investments in knowledge-based industries such as IT. Karunanayake said that GSL has prepared TRIPS-compliant IPR legislation that it expects to enact soon; the legislation is currently before the Cabinet and will be debated in Parliament in early February. A/S Lash replied that legislation was a good and necessary first step, but that enforcement of IPR was equally important. Many countries have solid IPR legislation on the books, but fail in enforcing it; Sri Lanka should set the regional standard for IPR not just in word but in deed as well. Karunanayake professed to understand the need for enforcement, and asked for U.S. help in training customs officials, police and judges; A/S Lash undertook to examine areas for possible U.S. assistance.

5. A/S Lash asked Karunanayake about the status of GSL's import regulations on biotech foods. While the U.S. was gratified that Sri Lanka indefinitely delayed its proposed ban on biotech food last year, we want to ensure that the Sri Lankan market remain open to biotech foods. Karunanayake assured A/S Lash that the biotech ban would not return. A/S Lash cautioned GSL against adopting any mandatory labeling scheme for biotech foods, pointing out that the U.S. objects strongly to any requirement that manufacturers certify and disclose levels of biotech content. WTO rules call for trade regulations to be based on science, and there is no scientific evidence to warrant restrictions of any kind, including mandatory labeling, on biotech foods. Karunanayake again assured A/S Lash that Sri Lanka's market would remain open to biotech foods, pledging that Sri Lanka would not adopt a mandatory labeling scheme.

16. A/S Lash also used the meeting with Karunanayake to press the GSL to move forward with several pending U.S. commercial projects. He noted that Sri Lanka is interested in attracting interest from more U.S. companies; the best way to do so is to enlist champions of Sri Lanka in corporate America - companies that have been successful doing business here and will encourage others to invest as well. A/S Lash raised Caterpillar's proposal before GSL to provide 100 MW of power generation; the U.S. expects a transparent process in awarding the tender, and hopes that Caterpillar's project will be approved. A/S Lash also brought up Tamsco's signed contract with the Sri Lankan Ministry of Defense to supply radar spares, which has been held up now for over a year; the principle of sanctity of contracts is at stake, and the U.S. expects GSL to honor its obligations in this contract in a timely manner. Finally, A/S Lash mentioned IMC Global's long-running proposal to mine phosphate in Eppawela (north-central Sri Lanka), noting that the project had the potential to be Sri Lanka's biggest-ever foreign investment.

17. A/S Lash noted that there are several sectors where U.S. companies could pursue business in Sri Lanka. Companies like Caterpillar are already exploring the power sector, but there are numerous other U.S. firms who could bring expertise to Sri Lanka in the broader infrastructure sector. IT is another area where U.S. companies will likely show interest, provided they can be assured of sound intellectual property protection. In addition, A/S Lash urged GSL to open up its educational system to private institutions, noting the demonstrated competitive advantage of the U.S. in this sector.

18. Karunanayake inquired about the AFL-CIO's recent petition to USTR to revoke Sri Lanka's GSP privileges. (Note: The AFL-CIO's petition asks for revocation of GSP for Sri Lanka based on alleged restrictions on union activity in Export Processing Zones here. End Note.) A/S Lash explained the background of the GSP program and the role of the private sector and NGOs in the certification process. The U.S. government makes GSP decisions on the basis of all relevant information, he said, and it was impossible to predict what the outcome would be in Sri Lanka's case.

19. Karunanayake also asked for "swing" on quota items, noting that keeping employment going in the apparel industry would be critical to Sri Lanka's prospects for peace. A/S Lash explained the extreme difficulties in making any changes to the quota system. Many countries - including many very close U.S. allies - have requested quota swing and come away empty-handed. A/S Lash promised to look into the matter but made it clear he was not optimistic.

Meeting with Minister of Finance

10. A/S Lash and Ambassador Wills met on December 20 with Minister of Finance K.N. Choksy. They discussed many of the same themes A/S Lash covered above with the Minister of Commerce, including the Caterpillar, Tamsco and IMC Global proposals. A/S Lash asked Choksy about the status of GSL's economic reform program. Choksy detailed the government's privatization efforts, highlighting what the government had already sold stakes in (petroleum, buses, telecom) and what were the next items on the block (insurance, banking). A/S Lash raised government tender procedures and the need for complete transparency at every stage of the process. Choksy said he hoped the privatizations would further decrease the government's role in tenders. For any remaining public tenders, GSL has set up a board to speed up the process; only tenders above a certain threshold (\$2.5 million) would need to go to the Cabinet for approval.

11. Choksy emphasized his government's desire for greater commercial engagement with the U.S., noting that two-way trade was currently heavily in Sri Lanka's favor. Choksy asked what the high-potential sectors for U.S. companies in Sri Lanka might be. A/S Lash and the Ambassador listed infrastructure (especially power), IT and education as the key sectors where U.S. companies could profitably participate. A/S Lash noted that education in particular was an area where the U.S. has a competitive advantage; opening up Sri Lanka to private education would attract interest from major U.S. institutions, whose presence here would bring big benefits to the Sri Lankan populace.

Meeting with Board of Investment

12. A/S Lash and Ambassador Wills met with Board of Investment (BOI) Chairman Arjunna Mahendran December 20. After viewing a BOI video presentation on what Sri Lanka offers the foreign investor, A/S Lash encouraged Mahendran to keep pushing economic reform within the government. The foreign investor looks closely at issues such as transparency, intellectual property protection and the level/pace of privatization. A/S Lash cautioned Mahendran against letting other countries in the

region export their IPR violations to Sri Lanka. If Sri Lanka does a better job cracking down on import of pirated products, U.S. investors will be more inclined to trust their intellectual property assets to this market. Improving the local educational system, A/S Lash added, would enable Sri Lanka to supply skilled workers in the quantities that foreign investors demand. A/S Lash encouraged Sri Lanka to open its educational system across the board to private operators, from vocational training to university and professional education; many U.S. institutions would likely show interest in entering the Sri Lankan educational market. A/S Lash also emphasized the importance of Sri Lanka raising its profile in the U.S., now that peace was developing. He pressed for Sri Lanka to approve pending commercial deals (Caterpillar, Tamsco and IMC Global), explaining again the importance of cultivating champions of Sri Lanka in corporate America.

Meetings with Business Representatives

13. In a December 20 working breakfast hosted by the American Chamber of Commerce, A/S Lash elicited the views of senior AmCham members on the investment climate in Sri Lanka. Members described the local environment for business as generally positive - few restrictions on imports, a talented and literate labor force and a BOI that truly streamlines investment approvals. AmCham members raised several concerns, though. Many commented that Sri Lanka's labor laws were too restrictive (especially regarding terminations), discouraging possible new investors from entering the market. Telecom policy was also a big hindrance to productivity. Though the government had nominally sold off part of Sri Lanka Telecom, the company still controls the market in the absence of a truly independent telecom regulator. As a result bandwidth is poor and line charges are high. Members also decried the current level of IPR protection in Sri Lanka, noting that GSL seems reluctant to crack down on pirated knock-offs brought in from China. A/S Lash emphasized that a main goal of the increased commercial engagement with Sri Lanka was to improve the atmosphere for U.S. companies doing business here. He asked AmCham reps to continue to provide input to U.S. officials, so the U.S. can prod Sri Lanka toward greater openness and transparency.

14. A/S Lash also met December 20 with the Ceylon Chamber of Commerce (CCC), Sri Lanka's oldest and most active business chamber, to hear members' views on the local investment climate and opportunities for U.S. companies. A/S Lash emphasized the need for greater two-way trade between the U.S. and Sri Lanka, noting that the trade imbalance was currently 10:1 in Sri Lanka's favor. Chamber members offered that the best prospect for increasing U.S. exports was textile fabric, and that the CCC was looking for ways to connect U.S. textile suppliers with Sri Lankan apparel manufacturers. A/S Lash asked members what their biggest concerns were on the investment climate. Political instability, including the still nascent peace process, and a poor tertiary education system were the greatest obstacles to growth, members said. A/S Lash pressed CCC to lobby the government hard to open the education system, noting that major U.S. institutions could play an active and positive role in the Sri Lankan education sector. Members praised the USAID-funded competitiveness initiative for its role in developing certain sectors and asked for additional technical assistance in education, job creation and vocational training.

Media reaction

15. Lash's visit generated lavish press coverage. A December 13 Embassy press release announcing his visit appeared in independent and government-owned dailies, both English and vernacular, under headlines such as "American trade minister arrives," "U.S. Asst. Secretary of Trade will be in Sri Lanka next week," and "U.S. Asst. Trade Secretary's visit to Sri Lanka." On December 20 the "Financial Times" section of the DAILY MIRROR (independent English daily) carried Lash's picture and c.v., plus a table of U.S.-Sri Lanka trade data under the headline "US trade with Sri Lanka." On December 20 the Assistant Secretary and Ambassador Wills convened a press conference for Sri Lanka's business, commercial, and finance journalists. The conference resonated in English and vernacular newspapers through the weekend. "Lanka's chances of attracting foreign investment in IT look rosy - US Asst. Commerce Secy" said the ISLAND (opposition English daily). A similar story appeared in DINAMINA (government-owned Sinhala daily) under the headline "Sri Lanka has achieved the capabilities to attract foreign investment in many spheres." THINAKARAN (government-owned Tamil daily) quoted Lash: "Conducive environment for investment in Sri Lanka." The MIRROR focused on Lash's compliance message with a story headlined "US wants Lanka to nab pirated imports," and the ISLAND followed suit with "US seeks crackdown against pirated software, movies and music here." And many of the Island's dailies highlighted the linkages that the Assistant Secretary and the Ambassador drew between peace and prosperity. One

example: "Peace will grow Lanka-US investment, trade"
(MIRROR).

Comment

¶16. A/S Lash's visit reinforced many of the same messages delivered by Deputy USTR Ambassador Huntsman during the first meeting of the bilateral Trade and Investment Council last month. It is now clear to GSL that achieving an enhanced trade relationship with the U.S. will depend on its moving aggressively to improve the local investment climate. A/S Lash's emphasis throughout the visit on IPR protection sent a strong signal to GSL that the U.S. will be watching its progress on this issue in particular in the coming months. To a large extent, we will be able to gauge GSL's commitment to overall reform by how quickly and fully it improves IPR legislation and enforcement.

¶17. A/S Lash has cleared this cable.
WILLS